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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Implementation of Section 309(j)
of the Communications Act -
Competitive Bidding)

PP Docket No. 93-253

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**EX PARTE COMMENTS
ON PETITIONS FOR RECONSIDERATION**

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III. CONCLUSION

OBRA ushered in a new method for the commercial allocation of a portion of the electromagnetic spectrum. On June 29, 1994, the FCC adopted competitive bidding procedures for Broadband PCS. This process has been entered into by the Commission and by potential applicants without the benefit of precedent. Because of the clear Congressional mandate with respect to DE's, and because of the significant economic, social and political importance of this endeavor, the Commission must re-examine its rules as actual market developments warrant. Further, the Commission has the obligation to modify its rules to take account of market experience and to fulfill Congressional intent.

NAIC's proposals in this matter are being presented at this time as a consequence of recent and specific developments in the PCS marketplace since June 29. The results of the process to date are instructive and serve as a warning signal to the Commission that significant modifications to its rules are required if PCS licenses are to be disseminated widely to DEs. Since June 29:

- Mergers and concentration of control among large telecommunications entities for the purpose of bidding on broadband PCS has accelerated.
- There is strong interest and desire among DE's in acquiring licenses in the C and F entrepreneurial blocks. And, a large number of potential applicants have emerged.
- On a relative basis, and despite formidable barriers, DE's have shown the ability to raise bid capital.
- To our knowledge, no alliances between DE's and major telecommunications entities have been formed.

Ironically, the absence of financial alliances between DE's and large telcoms prior to bidding may be fortuitous. While the Commission may have contemplated a different result, as previously noted, the direct or indirect participation of large telcoms in the entrepreneurial C and F block auctions is antithetical to the realization of widespread, independent and long-term DE PCS license ownership.

Indeed, "up-front" partnering between a DE and a major telcom player will make the DE a captive of its "partner". For example, in bidding for a license, the captive DE will have little independence. Relying on the financial resources of its partner, the DE will be in fact told how much to bid, when and if to raise the bid, and when to cease bidding.

"Up-front" partnering has another important and negative effect. It lessens the opportunity for, and the probability that, consortia of successful DE bidders can be formed which

could create new and independent competitive forces in the telecommunications marketplace.

Alternative outcomes are possible. The Commission should not rush to initiate the Broadband PCS auctions without taking remedial steps that can avoid a policy failure and attendant political and public relations fallout. At the end of the auction process, the Commission should be able to clearly demonstrate through the outcome of the auctions, that the process itself promoted a fair and reasonable competition among DEs.

NAIC respectfully requests that the Commission modify its Broadband PCS rules in accordance with the recommendations set forth herein and discussed.

SUMMARY

In the Omnibus Budget Reconciliation Act of 1993 (OBRA), Congress expressed its intention that PCS licenses be obtained by a wide variety of applicants including businesses owned by minority groups. To achieve this result and to promote economic opportunity and the rapid deployment of new technologies, Congress authorized and directed the Commission to employ competitive bidding procedures. Specifically, OBRA requires, among other things, that the procedures employed by the Commission result in "disseminating licenses" among minority and women owned firms, small businesses, and rural telephone companies ("designated entities" or "DEs").

The Commission has adopted a number of rules designed to implement Congress' mandate. The National Association of Investment Companies (NAIC) welcomes the Commission's actions in this regard. However, we are gravely concerned that, notwithstanding the Commission's good faith efforts in practice and as applied in the marketplace, it has become clear that the allowance in the bidding procedures of "upfront" partnering will not result in diverse ownership of PCS licenses by entrepreneurial DEs as designed or originally intended. One of the consequences of not achieving Congress' or the Commission's intent is the risk of public ridicule of the Administration and the Commission.

Accordingly, in order to achieve the result mandated by OBRA, the Commission should modify its auction rules with respect to the reserved "Entrepreneurial Block" licenses as follows:

1. Bidders for entrepreneurial block licenses should be limited to those who have not forged financial alliances with major telecommunications firms and others bidding in the A or B block prior to, and for the purpose of participation in the entrepreneurial block auctions. Such alliances would be allowed after the auction, as long as they conform to the Commission's rules.
2. The Commission's definition regarding businesses owned by members of minority groups and its allocation rules should be modified to include minority oriented venture capital firms (as defined hereafter) as qualifying members of a DEs' control group.
3. The auctions for Blocks C and F should not be held at the same time, and the auction of Block C should take place prior to the auction of Block F.
4. The Commission should adopt further enhancements to the bidding, licensing and build-out process that would: a) permit the government financed debt of a license to be converted to equity, and b) establish an equity pool from a portion of the proceeds of the auction for investment in a winning DE.

The National Association of Investment Companies (NAIC) is the industry association representing venture capital firms that primarily invest in businesses owned by members of minority groups. Today, approximately 130 NAIC members include privately-owned specialized small business investment companies, licensed and regulated by the U.S. Small Business Administration; privately-owned venture capital firms; and a number of investment companies chartered by state and local governments to do focused investing, primarily in minority businesses.

Given the 22-year experience and focus of the minority venture capital industry, NAIC member companies are uniquely committed, qualified and experienced to provide financial assistance to members of minority groups and women. Almost all of the minority-owned telecommunications companies which hold FCC licenses in the U.S., were financed by NAIC members. While these minority-owned telecommunications companies represent less than 1 percent of total ownership in this industry, equity investments from NAIC members have and will continue to fuel the growth of minority group participation and ownership in the communications and information sector of our economy.

COMMENTS

I. DESIGNATED ENTITY PARTICIPATION IN THE PROVISION OF SPECTRUM BASED SERVICES: CONGRESSIONAL INTENT

Section 309(j) of the Omnibus Reconciliation Act of 1993 (OBRA) (47 U.S.C. § 309(j)), provides express authority to the Commission to utilize competitive bidding procedures in the allocation of electromagnetic spectrum that satisfy certain policy considerations. Consonant with the goals of promoting new technologies, and efficiently utilizing the spectrum for the public benefit, Congress also directed the Commission to promote economic opportunity and competition by "disseminating licenses among a wide variety of applicants including small businesses, rural telephone companies, and businesses owned by members of minority groups and women", collectively referred to as "designated entities". (47 U.S.C. § 309(j)(2)(B)) (emphasis added). Further, in prescribing regulations pursuant to this mandate, Congress charged the Commission with ensuring that these designated entities are "given the opportunity to participate in the provision of spectrum-based services" (47 U.S.C. § 309(j)(4)). (emphasis added)

Unquestionably, Congress wants the Commission to focus on the results of the bidding and auction process. Through OBRA, Congress makes clear that post-auctioning, licenses must be widely "disseminated" to DEs.

In May, 1994, the House Small Business Subcommittee on Minority Enterprise, Finance and Urban Development, held a hearing on "Discrimination in the Telecommunications Industry". In his opening statement, Chairman Kweisi Mfume stated, "... the limited nature of radio frequency spectrum, and the high demand, makes spectrum licenses a most valuable commodity. Thus, the specific rules chosen by the Commission to ensure designated entity participation in spectrum-based services is absolutely critical." (Discrimination in the Telecommunications Industry, May 20, 1994: Hearing Before the Subcommittee on Minority Enterprise, Finance and Urban Development, U.S. House of Representatives, 103rd Congress, 2nd Session (Opening Statement of the Honorable Kweisi Mfume)). When stating the underlying objective for the hearing, which examined the historical impediments to minority-owned businesses entering the telecommunications industry, Chairman Mfume concluded by stating that he hoped to "... encourage the FCC to adapt its regulatory scheme to recognize and counterbalance the entry barriers in PCS and other emerging technologies". (*id.*)

In announcing the Competitive Bidding Procedures for Broadband PCS, Commission Chairman Reed Hundt stated, " In the long and tragic history of inequality between races and gender in America, today we are creating the greatest single opportunity made available to minorities and women."

II. NAIC PROPOSALS

The NAIC hereby submits its Comments in the above captioned proceeding. NAIC contends that the rules for the entrepreneurial block auction, as presently constructed, pose a very high risk of eliminating any realistic opportunity for diverse ownership of PCS licenses by a broad pool of qualified DEs as intended by OBRA. In fact, it is now clear that only those DEs allied with large telcom partners, upfront, will be likely winners. In reality, those DEs will not represent entrepreneurial interests but rather the interests of their telcom partners, further frustrating Congressional intent.

A. MODIFICATIONS TO ATTRIBUTION RULES: PROHIBITION OF FINANCIAL ALLIANCES IN THE BIDDING FOR ENTREPRENEURIAL BLOCKS

1. Financial Alliances Prohibition

As part of its efforts to ensure that DEs are given the opportunity to participate in the provision of broadband PCS, the Commission reserved certain licenses in the "entrepreneurs' block". Eligible bidders for licenses within this block are only those firms which meet the DE qualifications criteria. This structure is designed to promote a genuine competition between DEs, devoid of the extraordinary influence that large companies necessarily have on the outcome of the auction, due to their capital and financial strength.

NAIC strongly believes that the Commission's proposed attribution rules for the entrepreneurs' block auctions will indirectly permit large companies to influence and determine the auction outcomes. As presently drafted, the proposed Commission attribution rules will allow extremely large companies that may not bid on the entrepreneurs' block to invest in DEs that bid on this block. The proposed rules will allow a DE to obtain investments representing up to 75 percent of their passive equity from larger companies, so long as each investor holds no more than a 25 percent passive equity interest. Moreover, minority companies will be permitted to have a single investor, no matter how large, and hold a passive equity interest up to 49.9 percent. The intent of the aforementioned attribution rule is to assist minorities in raising capital while enabling them to maintain control of their enterprise. Realistically however, allowing the financial alliances to occur prior to the auction, minimizes and diminishes a DE's ability to control its fate once in the auction.

Since the announcement of the Third Report and Order, May 24, 1994, it is difficult to ascertain whether any meaningful alliances with DEs have occurred, however, a recent trend which should be of concern to the Commission is the formation of alliances among major players. An article which appeared in the Washington Post (*Washington Post*, October 25, 1994, Section C1, Column 2), summarized only a few of the alliances forged by the country's largest telecommunications companies.

- AT&T recently completed its \$11.5 billion acquisition of McCaw Cellular

Communications, Inc.

- Sprint is expected to announce today an alliance with Tele-Communications, Inc., Comcast Corp. and Cox Enterprises.
- Bell Atlantic's team includes Nynex Corp., US West Inc., and Airtouch Communications

It is anticipated that these larger companies will first bid on major markets in the Major Trading Area (MTA) spectrum blocks, subsequently turning their attention and powerful financial resources to the Basic Trading Area (BTA) licenses more specifically, the "entrepreneurial blocks". These powerful alliances, which have been formed by the larger companies, therefore dictate that the choice of partnering is not determined by DEs, but rather, left under the complete control of the existing major telcoms.

NAIC acknowledges that a successful DE applicant may need to develop a strategic alliance with a large telcom to exploit and develop its license. However, the timing of this alliance is critical to the achievement of Congressional intent that licenses be widely disseminated. Further, NAIC believes that development of strategic financial alliances between large companies and DEs should only occur after the auction process and the award of licenses. Alliances in advance will lead to indirect control of the bidding by large companies, and result in DE winners and losers based on the calculation direction of large companies. Moreover, in all likelihood, the current rules will result in the concentration of license ownership in a limited segment of DEs. In fact, upfront partnering lessens the opportunity for consortia among successful DE bidders that could create new and independent competitive forces in the telecommunications marketplace.

We do not believe that this is the result Congress intended or that which the Commission desires. It is the intent of Congress that the Commission adopt procedures to make safeguard against fronts involving the manipulation of minority-owned companies and to prevent concentration of license ownership in large firms or in a small favored group of DEs.

It was the intent of Congress to enact legislation to provide safeguards against "fronts" involving the manipulation of minority-owned companies. Indeed, such exploitation does harm to the positive objectives the Commission's policies are designed to achieve.

For instance, a manipulative scheme would involve a larger entity using its financial clout to control the DE in the bid process. As a result, the competitive process among DEs is dismantled. DEs which form alliances with the larger companies will have access to financial resources far beyond their own capacity to bid. Thus, the larger companies will drive the process and price of the auctions and ultimately will decide which DE will be successful in winning a license. The intent of the formation of entrepreneurial blocks was designed to foster competition among, and promote the attainment of, licenses by independent DEs, not large telcoms' manipulation of DEs.

NAIC believes that exclusion of the large players from participating in the bidding process for the entrepreneurial blocks can be accomplished through full disclosure. In attempting to achieve this exclusion, the Commission would have to require that all DEs bidding on an entrepreneurial block fully disclose financial alliances. We believe that the Commission's existing remedies for misrepresentation, and its well known record for enforcing them, will effectively deter non-compliance.

Therefore, in order for the process to be competitive among qualified DEs, the large telcoms must be removed. NAIC proposes that major players be prohibited from aligning upfront with DEs in order to allow them to direct their limited resources to a limited number of licenses and compete among themselves. This true competitive process would result in the potential creation of the largest number of qualified DE PCS license holders.

2. Inclusion of Minority Oriented Venture Capital Companies as Qualified Members of DE Control Groups

The Commission has recognized that the primary impediment to license ownership by minority-owned applicants is lack of access to capital. To raise funds to compete in the auction process, minority DE's must look to a variety of financing sources.

As previously noted, minority oriented venture capital firms have a 22-year history of financing minority entrepreneurs and minority-owned companies. Under the Commission's proposed rules, an entity qualifies as a minority-owned business only if it has a "control group" composed 100 percent of members of minority groups. Because many minority venture capital funds typically have pension funds as limited partners, or may have institutions as shareholders, they are not literally "composed 100 percent of members of minority groups" (e.g., the majority of the pension plan beneficiaries may or may not be members of minority groups).

The minority venture capital industry is prepared to assist in the formation of, and to fund, minority "control groups" of PCS applicants. However, as currently drafted, the Commission rules would substantially impair minority venture capital firms from assisting minority DE applicants for the C and F Block licenses.

With the increase and recognition of talented minority fund managers, minority venture capital funds are beginning to receive the backing of large pension funds and other institutional investors. Such funds represent a significant pool of capital aggregated and available to provide financial assistance to minority DE applicants should the Commission modify its rules to permit such participation. NAIC suggests the following definition of a qualified "minority oriented venture capital fund" for this purpose. A qualified minority oriented venture capital fund is a fund which has not less than 75 percent of its portfolio invested in companies owned by members of minority groups.

B. BIFURCATION

NAIC proposes that the Commission hold separate auctions for the respective entrepreneurial blocks; C and F. Distinctly separate auctions would allow the Commission to make necessary adjustments to the rules armed with knowledge and experience from the first entrepreneurial block auction without having to revisit the entire rulemaking process. The Commissions' experience with the Narrowband auction illustrates the wisdom of this approach.

C. CONVERSION OF DEBT TO EQUITY

The Commission has adopted a variety of means to encourage DE participation in the PCS industry, including tax certificates, bidding credits, and installment payments. NAIC believes that these preferences, however, may not be adequate to enable independent DE's to attract the requisite capital to finance both license acquisition and construction. The installment payment plan, alone, may not be sufficient to address the financing needs of DEs or be adequate to accomplish the policy goal of dissemination and long-term ownership of licenses.

Given the cash requirements within the first five years of a license, including interest payments, microwave relocation and system construction cost, and thereafter, principal repayment, operating and marketing costs, installment payments alone may not permit DEs to become long-term license owners. The current installment payment plan may lead to cash constraints and early sales of DE controlled businesses to non-DEs.

NAIC suggests that a more flexible arrangement, the conversion of debt to equity, will assist DEs in their endeavors to remain independent and viable owners and operators of PCS licenses. An equity instrument will increase the probability of DEs acquiring licenses, raising additional private capital and operating successful businesses which can provide meaningful and lasting services to the public.

D. EQUITY POOL

As the build-out and operating costs of a license can be even more costly than the license itself, NAIC proposes that an equity pool be formed from a portion of the proceeds of the auctions. This pool would be used for the express purpose of assisting DEs with the construction and operation of a license. While the creation of such a resource would likely require Congressional approval, the current authority of the National Telecommunications Information Administration to fund activities to promote telecommunications infrastructure, interconnection and interoperability, could serve as a model by which this pool can be administered.